



Board of Administration
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The Honorable Arnold Schwarzenegger
Governor of California
And
Honorable Members of the California Legislature

On behalf of the California Public Employees' Retirement System's (CalPERS) Board of Administration (Board), I am pleased to forward the audited Basic Financial Statements for the fiscal year ended June 30, 2007, as required by Government Code Section 20228. The following funds are included in these statements:

Public Employees' Retirement Fund (PERF)
Legislators' Retirement Fund (LRF)
Judges' Retirement Fund (JRF)
Judges' Retirement Fund II (JRF II)
State Peace Officers & Fire Fighters Defined Contribution Fund (SPOFF)
Old Age and Survivors' Insurance (OASI) Revolving Fund (Social Security)
Public Employees' Contingency Reserve Proprietary Fund (CRF)
Public Employees' Contingency Reserve Agency Fund (CRF)
Public Employees' Health Care Fund (HCF)
Public Employees' Deferred Compensation Fund (DCF)
Volunteer Firefighters' Length of Service Award Fund (VFF)
Public Employees' Long Term Care Fund (LTCF)
Public Agency Deferred Compensation Program (IRC 457)
Public Employees' Replacement Benefit Fund (RBF)
Supplemental Contributions Program Fund (SCPF)
Special Deposit Fund (SDF)
California Employers' Retiree Benefit Trust Fund (CERBTF)

The Basic Financial Statements received an unqualified opinion from the auditors. This opinion read in part:

"In our opinion, such basic financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the fiduciary funds, the changes in assets and liabilities of the agency fund and the net assets of the proprietary funds of the System, as of June 30, 2007, and the related changes in fiduciary net assets and the operations and cash flows for the proprietary funds for the year then ended in conformity with accounting principles generally accepted in the United States of America."

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The Board has again noted the lack of adequate funding of the JRF, and requests your review of Footnote 5, beginning on page 53, as displayed in the JRF section. Actual contributions made by the State to the JRF were significantly less than the actuarially determined annual required contribution.

Because of the significance of the issue, the auditors included an explanatory paragraph in their opinion to emphasize the situation which reads:

"As discussed in Note 5 to the basic financial statements, actual contributions to the Judges' Retirement Fund made by the State of California were materially less than the actuarially determined annual required contribution. Additionally, current year contributions made by the State of California were used to pay current year benefits. Management and legal counsel believe that the State of California is legally required to provide funding sufficient to pay benefits when due."

California courts have held that members of a public pension plan have a contractual right to an actuarially-sound plan. The Board continues to be very concerned over the lack of adequate funding for the JRF. This inadequacy could threaten the financial security of the benefits promised under the JRF. Also, under the pay-as-you-go basis, the opportunity to significantly reduce the State's overall cost of funding the plan through investment earnings is eliminated. The Board is very interested in working with all interested parties to correct this situation. In this regard, the CalPERS Actuary will be preparing a report of funding alternatives for the State to consider.

If you or your staff have any questions regarding this report, or are interested in obtaining more information on this matter, please contact Gloria Moore Andrews, Deputy Executive Officer – Operations at (916) 795-1251 or at the address noted above.

Respectfully,

Rob Feckner, President
Board of Administration

Enclosure

cc: Fred Buenrostro
Chief Executive Officer